المجموعة المالية - هيرميس
EFG HERMES

BANK AL JAZIRA (BAJ)

Earnings Continue to Decline

11 AUGUST 2008

SAUDI | BANKING

ST Rec. : Neutral	Current Price*: SAR 28.0
LT Rec. : Neutral	LT Fair Value : SAR 39.5

• **Results Fall Well Short of Expectations:** Bank Aljazira's (BAJ) earnings for 2Q2008 earnings declined 51.8% Y-o-Y and 34.9% Q-o-Q to SAR99.9 million (EPS: SAR0.33) driven by drop in fee and commission income and higher operating expenses. The announced results were significantly below our expectation of SAR172 million primarily due to lower-than-expected fee and commission income and higher-than-expected provisioning expense. Total earnings for 1H2008 declined 50.3% Y-o-Y to SAR253 million (EPS: SAR0.84).

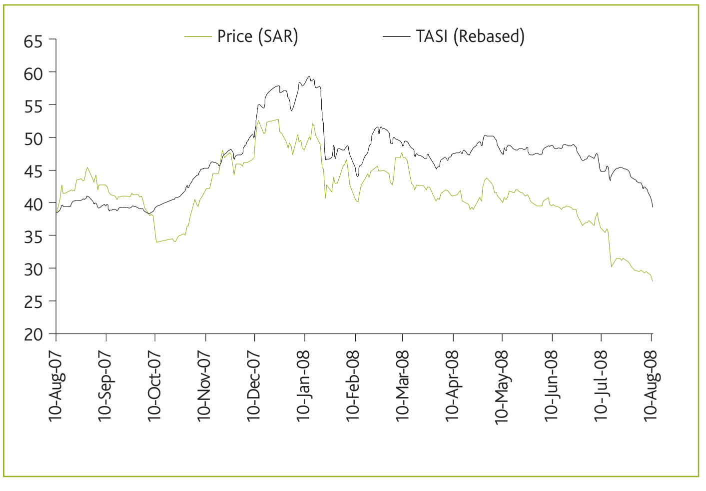
• **Fee and Commission Income Continue to Disappoint:** Non-special commission income declined 21.3% Y-o-Y and 6.7% Q-o-Q to SAR163 million driven by a 16.8% Y-o-Y and 12.0% Q-o-Q decline in fee and commission income. After a 31.1% Q-o-Q jump in 1Q2008, we were expecting fee and commission income to remain around 1Q2008 levels. Investment income also declined 58.8% Y-o-Y to SAR11 million, which we believe is primarily due to the decline in Saudi stock market. Unlike other banks, BAJ's investment portfolio primarily consists of domestic market securities.

• **Loans Double, But Net Special Commission Income Growth Muted:** BAJ's balance sheet recorded strong growth, with total assets surging 54.5% Y-o-Y and 6.0% Q-o-Q to SAR24.3 billion. This was primarily due to an almost doubling of net loans, which grew 94.5% Y-o-Y and 17.5% Q-o-Q to SAR14.1 billion. However, the strong growth in loans did not flow through to the income statement as net special commission income grew by only 7.7% Y-o-Y as net interest spreads declined by 25 bps Y-o-Y and 8 bps Q-o-Q to 3.74%.

• **Costs Surge:** Operating costs increased 31.2% Y-o-Y and 11.1% Q-o-Q to SAR208 million, with strong growth in all the main categories of operating expenses. Salary and related expenses surged 37.6% Y-o-Y and 17.5% Q-o-Q to SAR120 million, which we believe has been driven by BAJ's focus on growing the core banking business. The cost-to-income ratio increased to 62.7%, one of the highest among Saudi banks, due to sustained growth in operating expenses, while overall revenues have continued to decline. Provision costs also rose by almost 13x Q-o-Q to SAR23 million, which in our opinion has been due to strong growth in the loan book over the last 18 months, necessitating higher provisions.

• **Recommendation:** We will be reviewing our earning estimates for BAJ after a higher-than-expected drop in earnings in 2Q2008. Fee and commission income continued to disappoint against our expectation and is likely to miss our full-year target, especially as volumes on the Saudi stock market have failed to recover. With broking commissions still accounting for a high proportion of BAJ's revenues, continued volatility in the stock market and low volumes are likely to keep BAJ's revenues depressed. While BAJ's balance sheet has grown strongly over the last 18 months, primarily due to almost a doubling of net loans over the last one year, it has failed to boost net special commission income. The stock price has reacted to the disappointing results, declining by 20% since the announcement of 2Q2008 earnings. We currently maintain our ST/LT Neutral stance on BAJ.

FLASH NOTE



	2008e	2009e	2010e
EPS	2.21	2.65	2.99
P/E* (x)	12.65	10.56	9.36
DPS	0.44	0.53	0.60
Div. Yield*	1.6%	1.9%	2.1%
BVPS	17.28	19.41	21.80
P/BV* (x)	1.62	1.44	1.28

Figures in SAR unless otherwise stated

Stock Data	
Last Ex-Div Date	*SAR0.38 on 19 April 2008*
Mkt. Val. (mn)	*SAR 8,400*
Shares (mn)	*300.0*
Av. Mthly Liqd. (mn)	*SAR 878.6*
52-Week High / Low	*SAR52.69 / 28.00*
Bloomberg / Reuters	*BJAZ AB / 1020.SE*
Est. Free Float	*52.87%*

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**prices as of 10 August 2008*

Table 1: Income Statement

(SAR mn)	2Q2007	1Q2008	2Q2008	Y-o-Y	Q-o-Q
Special Commission Income	227	269	254	12.0%	-5.5%
Special Commission Expense	71	102	87	21.3%	-15.3%
Net Special Commission Income	**156**	**167**	**168**	**7.7%**	**0.5%**
Non-Special Commission Income					
Fees from Banking Services	177	167	147	-16.8%	-12.0%
Exchange Income	4	4	5	32.9%	35.8%
Investment Income	27	4	11	-58.8%	179.6%
Total Non-Special Commission Income	**208**	**175**	**163**	**-21.3%**	**-6.7%**
Total Income	**363**	**342**	**331**	**-8.9%**	**-3.2%**
Operating Expenses					
Salaries & Related Expenses	87	102	120	37.6%	17.5%
Rent & Premises	13	16	15	23.3%	-5.1%
Other Operating Expenses	59	69	72	23.3%	5.5%
Total Operating Expenses	**158**	**187**	**208**	**31.2%**	**11.1%**
Operating Profit	**205**	**155**	**123**	**-39.8%**	**-20.4%**
Provision for Credit Losses	(2)	2	23	N/A	1,266%
Net Income	**207**	**153**	**100**	**-51.8%**	**-34.9%**
EPS (SAR)	1	1	-		
Ratios					
Net Interest Spreads		4.0%	3.8%		3.7%
Non Special Commission Inc/Total Income		57.1%	51.2%		49.3%
Cost-to-Income		43.6%	54.7%		62.7%

Source: Bank Al Jazira, EFG-Hermes

Table 2: Balance Sheet

(SAR mn)	2Q2007	1Q2008	2Q2008	Y-o-Y	Q-o-Q
Assets					
Cash and balances with SAMA	1,018	1,302	1,906	87.2%	46.4%
Due from Banks & Fis	4,037	2,859	2,759	-31.7%	-3.5%
Investments	2,642	4,994	4,432	67.8%	-11.3%
Loans & Advances	7,197	11,914	14,001	94.5%	17.5%
Fixed Assets	455	470	467	2.6%	-0.5%
Other Assets	371	1,366	715	92.9%	-47.6%
Total Assets	**15,720**	**22,904**	**24,280**	**54.5%**	**6.0%**
Liabilities					
Customer Deposits	10,594	15,931	17,287	63.2%	8.5%
Due to Banks & Fis	374	1,663	1,644	339.9%	-1.1%
Other Liabilities	354	510	555	56.9%	8.9%
Total Liabilities	**11,322**	**18,103**	**19,486**	**72.1%**	**7.6%**
Shareholders' Equity					
Share Capital	2,250	2,250	3,000	33.3%	33.3%
Reserves	2,075	2,551	1,794	-13.6%	-29.7%
Total Equity	**4,325**	**4,801**	**4,794**	**10.8%**	**-0.1%**
Minority Interest	73	N/A	N/A	N/A	N/A
Total Equity & Liabilities	**15,720**	**22,904**	**24,280**	**54.5%**	**6.0%**

Source: Bank Al Jazira, EFG-Hermes

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